LOS ANGELES COUNTY

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United We Stand

TO ENRICH LIVES THROUGH EFFECTIVE AND CARING SERVICE

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To: Each Supervisor

From: Dave Lambertson
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Subject: **ENERGY UPDATE REPORT**

This is the eleventh in a series of regular reports requested by your Board to provide updates on the County's ongoing energy management activities. These reports are provided quarterly and discuss the status of key energy related issues and responses to Board Motions and requests. Natural gas prices and acquisition strategy is discussed on page 4 and the new Community Choice Aggregation program authorized under Assembly Bill 117 is discussed on page 5 of this report.

Electricity Rates

Southern California Edison (SCE) Surcharge Removal (Post PROACT Settlement Agreement)

SCE is proposing that the 4-cent per kilowatt-hour surcharge imposed on retail customers early in 2001 be partially removed. The surcharges were authorized by the CPUC to allow SCE (and other investor owned utilities) to cover ongoing costs and past debts associated with buying high-priced electricity during the energy crisis. SCE estimates their debts may be paid off sometime this fall. These proposed new rates must be approved by the CPUC.

We estimate that approximately 1.8-cents of the 4-cent surcharge will be removed. The remaining amount is needed to secure the bonds that pay the State back for purchasing electricity on behalf of SCE and to pay the State's current long-term energy contracts. A small portion of the remaining surcharges also helps subsidize lower rates for some residential customers and revenue shortfalls caused by existing direct access customers. It is expected that the Commission will approve the proposal shortly.

SCE General Rate Case

As reported in an earlier energy update, although the surcharge associated with the debt is being reduced, SCE has proposed new rates that request additional revenues to cover higher operating costs. SCE has requested $248 million over current revenues. The CPUC's Office of Ratepayer Advocates (ORA) has suggested SCE reduce their revenues by $116 million.

Over SCE's entire system, this proposal represents a slight increase in SCE's average rates. SCE has actually proposed rate decreases for large and medium sized customers. Smaller customers (including residential), street lighting, and agricultural pumping customers have larger rate increases scheduled. SCE's proposal also incorporates higher costs on the fixed component of their rates (costs for infrastructure that are not charged on a cents per kilowatt-hour basis). The details of this proceeding are expected to be negotiated in 2004. Due to the technical complexities and the wide range between SCE's and ORA's proposals, it is extremely difficult to assess the impact of this proposal to the County at this time.

The County has been an active intervener in this proceeding and has filed testimony on issues relating to the need to obtain data from SCE that would allow the County to better manage its energy demand. As a result of that testimony, SCE agreed to provide the data on terms acceptable to the County.

FERC Investigation on Price Manipulation in Western Markets

In the last Energy Update Report (April 3, 2003), we described FERC's report into electric and natural gas market manipulation in the Western United States. In May of this year, FERC addressed the four key issues before them. They are summarized below.

Complaint Against El Paso Corporation

FERC removed the CPUC's complaint against the El Paso Corporation for gas market manipulation from its docket pending completion of a global settlement agreement. The County has participated in the proceeding as an intervener and supported the position of California regulators and utilities. The County also filed an anti-trust lawsuit against El Paso and others in State court. FERC, among others, would be required to approve the global settlement agreement, which would resolve the lawsuit against El Paso at FERC and in State court. The global settlement is in the process of being finalized and will be submitted to FERC for its review and consideration.

County Counsel and ISD have been reviewing the terms of the global settlement agreement and other settlement documents, including a separate agreement between El Paso and the County (and ten other parties). Your Board was previously briefed on the terms of the settlement in closed session, and authorized the Interim Director of ISD, with the concurrence of County Counsel, to execute final settlement documents that conform in substance to the deal points fully briefed and discussed in closed session. The Interim Director of ISD intends to execute the separate agreement within a ten day period.

California Demand for Refunds

FERC increased the amount of California's refund due to electric and gas market manipulation to $3.3 billion from $1.8 billion. This increase was a result of the Commission's determination to base the calculation for damages on the cost of gas in the producing region, plus transportation to the border, rather than use the prices that resulted from El Paso's own market manipulation. The exact calculation of the refunds will be determined this summer, after the Commission receives and evaluates gas cost documentation from power sellers.

Renegotiation of Long Term Contracts

FERC has yet to issue a final decision on how it will treat billions of dollars worth of long term contracts entered into by California parties in response to the short-term market dysfunction and manipulation. It is expected that the Commission will not overturn those contracts. Two of the three Commissioners have expressed strong support for "contract sanctity" rather than "just and reasonable" rates. The decision is expected within the month.

Market Manipulation Investigation

FERC also found that a number of natural gas traders falsely reported natural gas prices to the publishers of price indices in favor of their trading positions taken in both the physical and financial markets. The County purchases some of its gas based on monthly natural gas indices. The Commission is holding a conference later this month on "energy price discovery and indices" to come up with reforms that will ensure the accuracy of prices at the California border.

Finally, FERC ordered Enron to repay $500 million and has initiated "show cause" proceedings that would revoke Enron's certificates to sell power and natural gas at market prices.

SCE/CPUC Settlement Agreement

As previously reported to your Board, SCE and the CPUC entered into a settlement agreement that allowed SCE to recover its costs for high priced electricity during the energy crisis. SCE was also allowed to maintain the surcharge and repay debts it had previously accumulated purchasing high priced power under their fixed rates.

The Utility Reform Network (TURN) appealed the Federal District Court's decision approving the settlement agreement. Last fall, the 9th Circuit Court of Appeals held that the settlement violated State law in a number of respects.

Subsequently, the 9th Circuit asked the California Supreme Court to review the matter. Since then, the parties have fully briefed and argued the matter before the Court. A decision is expected shortly.

Natural Gas Prices and Acquisition Strategy

On June 18, 2003, ISD briefed your offices on the natural gas market and an apparent, long-term supply and demand imbalance that has caused current and future prices to remain high. President Bush, Federal Reserve Chairman Alan Greenspan, and Secretary of Energy Spencer Abraham have all commented recently on the state of this industry. Overall, the increase in natural gas prices is due to the following:

- Existing supplies of natural gas may not meet increasing demand.
- Natural gas fired power plants are increasing in order to meet increased electric demand.
- Industrial use of gas, which has been depressed based on the slowdown in the national economy, may soon be increasing.
  To meet current residential demands during last winter, gas storage levels are at historic low levels.

These factors, and others, have driven future years' gas prices to between $4 and $6 per Million British Thermal Unit (MMBtu). As reported in past updates, gas prices throughout the 1990's were around $2 to $2.50 per MMBtu.

Except for the Pitchess Cogeneration Plant, ISD currently purchases natural gas for all large County accounts on a fixed price contract at $3.54 per MMBtu. This contract expires on June 30, 2003. Pitchess gas is purchased on an index because the County is reimbursed by SCE for natural gas at the California/Arizona border index price.

Beginning August 1, 2003, ISD will enter into three, fixed price, long-term contracts under the California Department of General Service's natural gas purchasing pool. The contract will consist of three, fixed price volumes, each with its own term. Essentially, this means that:

- One third of the load will be bought at prices bid and fixed for a one year period.
- One third of the load will be bought at prices bid and fixed for a two year period.
- One third of the load will be bought at prices bid and fixed for a three year period

This strategy will protect the County from price volatility and will provide a measure of budget stability for the next 3 fiscal years. It will result in an average cost (per MMBtu) that is less than ISD would receive under a single, one year contract for our entire load.

At the end of each fiscal year, ISD will renew one third of the gas load. If prices have dropped, ISD's portfolio will benefit. If prices have increased, ISD will have already "locked-in" attractive prices for two thirds of the gas load. This strategy is a conservative and typical purchasing practice in the industry.

Pitchess will continue to be supplied on an index-based contract and reimbursed by SCE at cost.

Retrofit Projects

Retrofit projects approved by your Board on May 28, 2003, totaling $4.1 million, are nearly complete. These projects include lighting and lighting controls installations at the Music Center, Olive View Hospital, the Museum of Natural History, the Registrar-Recorder headquarters, Central Juvenile Hall and Courthouses in Compton, San Fernando, Beverly Hills, Long Beach, Norwalk, and Malibu.

On June 4, 2002, your Board authorized ISD to sign contracts for energy projects funded by the CPUC's $3.3 million grant under its 3rd Party Local Energy Efficiency Program for 2002-03. These projects are underway and scheduled to be completed by the first quarter of calendar year 2004. The projects include lighting and lighting control retrofits, variable speed drive installations on building fan motors, and a new chiller at Harbor/UCLA Hospital.

ISD is continuing to identify new projects and potential funding sources and will report our progress in this area in future updates.

Community Choice Aggregation (CCA) – AB 117

CCA Description

At the June 18, 2003 briefing, ISD also briefed your offices on Assembly Bill 117 – Community Choice Aggregation (CCA). This bill was signed into law during last year's legislative session. CCA allows local governments on their own or through the formation of a Joint Powers Authority (JPA) to purchase retail energy for supply to all customers (residential, business, governmental, etc.) within their jurisdiction. Essentially, the local government or the JPA becomes what is referred to as an "Aggregator." CCA will only be available to customers within SCE, PG&E, and SDG&E territories.

A significant aspect of CCA is the "opt out" requirement. If an Aggregator decides to implement this program (i.e. purchase of energy) all customers within their jurisdiction are included in the purchase unless they actively "opt out" of the program.

To purchase retail energy, an Aggregator must prepare a CCA Program that is approved by the CPUC. The detailed rules and regulations that will guide CCA will be determined in a proceeding at the CPUC that is scheduled to begin in September of this year. Issues such as "opt out" procedures, billing, coordination with utilities, return to an incumbent utility, and determination of the utilities' actual energy costs as well as other issues will be addressed.

The County may serve as its own Aggregator for the unincorporated areas and/or join a Joint Powers Authority.

Energy Efficiency Funding Aspect of CCA

Another important feature of CCA is that the Aggregator may also control its own energy efficiency funding. Currently, SCE collects from all customers about 3% of the bill to support public benefits programs such as energy efficiency rebates and incentives. Under CCA, Aggregators may establish their own energy efficiency programs and request a portion of the 3% contribution to fund them. The CPUC is expected to provide initial guidelines about the use and implementation of energy efficiency funding under CCA in July of this year.

Potential CCA Pilot Program

At the June 18, 2003 briefing, a presentation was made by Navigant Consulting, Inc. (Navigant). Navigant has partnered with the California Energy Commission and the Local Government Commission for purposes of establishing a CCA pilot program. To accomplish this and to offset some of the costs, the Local Government Commission has provided funding of $750,000 to Navigant. Navigant is now inviting cities and counties to join their pilot program. The first phase of the pilot would only verify the economic feasibility of CCA. Next steps include participating in the CPUC's rulemaking proceeding and researching the issues related to establishing a JPA, as well as program implementation. ISD is considering joining Navigant's pilot program, at least initially, to determine the economic viability of CCA and to participate in the rulemaking proceeding at the CPUC. With the Local Government Commission grant offset, the County's portion of the cost is approximately $60,000. ISD has funding for this expense in the Utilities Budget under technical consulting and regulatory support.

ISD is committed to investigating the benefits of CCA for the County and believes it is advantageous to join the Navigant pilot program, as their grant would reduce ISD's expected expenditures to independently conduct this work with our own consultant. None of this preliminary work requires the County to join or establish a JPA. Nor would it require the County to submit a CCA Program Proposal. Our effort would only serve to validate if the program is beneficial and the logical next steps. ISD will notify your Board of our investigative results and request your approval relative to any JPA considerations and participation in any CCA program.

As a final note, the Southern California Cities Joint Powers Consortium (SCCJPC) was also present at the briefing. SCCJPC is a group of 10 cities located in the South Bay region that formed a JPA under deregulation to investigate aggregated energy purchases. They are now considering joining Navigant's pilot program as well as seeking other cities to join their JPA. SCCJPC have amended their by laws to include counties and have requested the County join their JPA. ISD will provide a recommendation to your Board at an appropriate time. Again, we will not commit to formally participating without Board approval.

California Energy Legislation

ISD is monitoring the status of two bills in the current legislative session that will impact the future of direct access: SB 888 (Dunn) and AB 428 (Richman). SB 888 originally seeks to terminate direct access (purchasing retail energy from a third party) and return the electric utility industry to pre-deregulation status. AB 428 seeks to preserve direct access and proposes a structure similar to the natural gas industry. AB 428 proposes to retain direct access for large customers (non-core in the gas industry) and delay it for smaller customers (core in the gas industry). ISD's regulatory consultants expect that either no direct access legislation will be passed or a non-core direct access option will be available. Currently, about 20% of the large customer load in California is being supplied by a third party provider.

National Energy Legislation

Congress is attempting to pass national energy legislation. Legislation has passed the House, and is currently being debated in the Senate. Both the House and Senate version under consideration ensure that the County's cogeneration contract is not adversely impacted. Broader electricity reform, particularly proposals that would vest more authority in federal regulators, is one of the most contentious issues and its fate is unknown. It is expected that energy legislation will go to a conference committee in September to work out differences between the two versions (assuming the Senate passes a bill by the end of July, as currently expected).

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